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UNITED NATIONS COMMISSION ON
INTERNATIONAL TRADE LAW
Working Group on
International Contract Practices
Fourteenth session
Vienna, 3-14 September 1990

PROVISIONAL AGENDA

1. Election of officers
2. Adoption of the agenda
3. Preparation of a uniform law on guarantees and stand-by letters of credit
4. Other business
5. Adoption of the report

Notes on the provisional agenda

Pursuant to a decision taken by the Commission at its twenty-first session, 1/ the Working Group on International Contract Practices devoted its twelfth session to a review of the draft Uniform Rules on Guarantees being prepared by the International Chamber of Commerce and to an examination of the desirability and feasibility of any future work by the Commission relating to greater uniformity at the statutory law level in respect of guarantees and stand-by letters of credit. The Working Group recommended that work be initiated on the preparation of a uniform law, whether in the form of a model law or in the form of a convention.

The Commission, at its twenty-second session, accepted the recommendation of the Working Group that work on a uniform law should be undertaken and

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1/ Report of the United Nations Commission on International Trade Law on the work of its twenty-first session, Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), para. 18.

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entrusted this task to the Working Group. 2/ At its thirteenth session held in New York from 8 to 18 January 1990, the Working Group commenced its task by considering, on the basis of a note by the Secretariat (A/CN.9/WG.II/WP.65), possible issues of a uniform law.

The Working Group is composed of all States members of the Commission. These are:

Argentina, Bulgaria, Cameroon, Canada, Chile, China, Costa Rica, Cuba, Cyprus, Czechoslovakia, Denmark, Egypt, France, Germany, Federal Republic of, Hungary, India, Iran (Islamic Republic of), Iraq, Italy, Japan, Kenya, Lesotho, Libyan Arab Jamahiriya, Mexico, Morocco, Netherlands, Nigeria, Sierra Leone, Singapore, Spain, Togo, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay, and Yugoslavia.

Item 1. Election of officers

The Working Group, in accordance with its practice at previous sessions, may wish to elect a Chairman and a Rapporteur.

Item 3. Preparation of a uniform law on guarantees and stand-by letters of credit

The Working Group will have before it at the fourteenth session a first draft of general provisions and of articles on establishment and expiry (A/CN.9/WG.II/WP.67) and a note by the Secretariat containing a discussion of further issues possibly to be dealt with in the uniform law on guarantees and stand-by letters of credit (A/CN.9/WG.II/WP.68).

The following documents will be made available at the session:

(a) Report of the Working Group on International Contract Practices on the work of its thirteenth session (A/CN.9/330);

(b) Note by the Secretariat discussing some issues of a uniform law: substantive scope of application, party autonomy and its limits, and rules of interpretation (A/CN.9/WG.II/WP.65);

(c) Report of the Working Group on International Contract Practices on the work of its twelfth session (A/CN.9/316);

(d) Note by the Secretariat setting forth tentative considerations on the preparation of a uniform law (A/CN.9/WG.II/WP.63);

(e) Report of the Secretary-General on stand-by letters of credit and guarantees (A/CN.9/301).

2/ Report of the United Nations Commission on International Trade Law on the work of its twenty-second session, Official Records of the General Assembly, Forty-Fourth session, Supplement No. 17 (A/44/17), para. 244.

Item 5. Adoption of the report

The Working Group may wish to adopt, at the close of its session, a report for submission to the twenty-fourth session of the Commission.

Meetings

The session of the Working Group will take place from 3 to 14 September 1990 at the Vienna International Centre. No meeting will be scheduled for Thursday, 13 September in order to allow for the preparation of the draft report of the session. Meeting hours will be from 9.30 to 12.30 and 14.00 to 17.00, except on Monday, 3 September 1990, when the meeting will commence at 10.30 am.

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UNITED NATIONS

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UNITED NATIONS COMMISSION ON
INTERNATIONAL TRADE LAW
Working Group on
International Contract Practices
Fourteenth session
Vienna, 3-14 September 1990

INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT

Uniform law on international guaranty letters: First draft of general provisions and article on establishment

Note by the Secretariat

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INTRODUCTION

1. At its thirteenth session, the Working Group on International Contract Practices considered, on the basis of a note by the Secretariat (A/CN.9/WG.II/WP.65), possible issues of a uniform law on independent guarantees and stand-by letters of credit (A/CN.9/330). Those issues concerned the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Working Group also engaged in a preliminary exchange of views on issues relating to the form and time of establishment of a guaranty letter. It requested the Secretariat to submit at the next session a first draft set of articles, with possible variants, on the issues considered during the thirteenth session.

2. The present note has been prepared pursuant to that request. It presents a first draft of general provisions relating to substantive scope and to interpretation, as well as a first draft of an article on establishment.

3. The style of presentation aims at facilitating the deliberations and decisions of the Working Group on the various issues dealt with in the draft provisions. Alternative wordings or particularly tentative suggestions are usually placed between square brackets; some alternative wordings that are elaborate or present different approaches are labelled as Variants. A Variant may contain an element that is interchangeable in that it may be used in connection with another Variant, depending on the Working Group's decision on the issue dealt with in that element. Once the Working Group has decided on an alternative wording or part thereof, the selected wording will be reviewed by the Secretariat for comprehensiveness and style.

4. Each draft provision is followed by remarks providing brief explanations of the draft provision and its elements or Variants; individual paragraph numbers of the remarks are placed as indicators (between square brackets, e.g. [3]) at that portion of the draft provision to which the remark most closely relates. For the sake of brevity, the remarks do not normally repeat or refer to the relevant considerations and conclusions of the Working Group at its thirteenth session which may be easily gathered from the report of that session (A/CN.9/330).

I. GENERAL PROVISIONS

Article 1. Scope of application [1]

This Law [2] applies to an international guaranty letter [3] [issued in this State] [4].

Remarks

1. The draft provisions in this note are given article headings for ease of reference during the considerations of the Working Group. If it were later decided to maintain headings in the final version, consideration could be given to adding an explanatory footnote like the one found in the UNCITRAL Model Law on International Commercial Arbitration: "Article headings are for reference purposes only and are not to be used for purposes of interpretation".

2. As regards the suggested use of the term "Law", it should be recalled that the mandate of the Working Group is to undertake work on a uniform law, whether in the form of a model law or in the form of a convention, and that the Working Group agreed to decide that question of form at a later stage. If the decision were to be in favour of the form of a convention, adjustments would have to be made in this and other draft provisions.

3. The term "international" is defined in draft article 4 and a definition of the term "guaranty letter" is provided in draft article 2.

4. The words between square brackets have been added primarily for the purpose of showing an appropriate location for any criterion of the territorial scope of application. While the suggested criterion might invite tentative consideration of the matter, a full discussion would probably be more appropriate at a later stage, in connection with possible rules on conflict of laws.

* * *

Article 2. Guaranty letter [1]

A guaranty letter, whether or not named guaranty letter, guarantee, bond, indemnity or stand-by letter of credit,[2] is an independent [3] undertaking, given by a bank or other institution or person ("guarantor") [at the request of its customer ("principal") or on the instruction of another bank, institution or person ("instructing party") acting at the request of its customer ("principal")][4] [, whether or not so requested or instructed by another institution or person],[5] to pay to another person ("beneficiary")[6] a certain or determinable amount of a specified currency [, unit of account or other item of value][7] in conformity with the terms of the undertaking.

Remarks

1. This draft provision presents a single definition of guaranty letter encompassing independent guarantees and stand-by letters of credit. This unitary approach seems justified in view of their functional equivalence and

essentially similar legal character. If a dual approach with two separate definitions were deemed necessary or preferable, consideration could be given to modelling the definitions on those found in the draft ICC Uniform Rules for Guarantees (URG) and the Uniform Customs and Practice for Documentary Credits (UCP). However, as regards the definition of "credit" in article 2 UCP, it would probably be necessary to express the guarantee function of a stand-by letter of credit, in contrast to the secured payment function of a traditional commercial letter of credit, by adding wording such as "given for the purpose of securing the beneficiary against the default of the principal or against another specified risk".

2. This wording is inspired by the words in article 1 URG "however named or described". It serves the purpose of clarifying that an undertaking may qualify as a guaranty letter irrespective of its name and indeed even without bearing any name. The suggested wording may serve the further purpose of illustrating the more common types of independent undertakings likely to fall under the new heading "guaranty letter". To further this aim of illustration and information, the list of types of undertakings should be carefully considered with a view to presenting the most appropriate names hitherto used in the various regions and languages.

3. The term "independent" is defined in draft article 3.

4. This wording is a shortened version of the corresponding element in article 2 a) URG. It leaves out, in particular, the words "and under the liability" (of the principal or the instructing party), which do not seem appropriate in the definition of an independent undertaking. The wording does not provide an appropriate context for defining such terms as "counter-guaranty letter" or "confirmation of guaranty letter", even though it covers those types of guaranty letters. The need for such definitions depends on whether any special provisions for these types of guaranty letter will be included in the operative rules of the uniform law.

5. This wording, by not requiring a request (of the principal or instructing party), includes those undertakings given by the guarantor on its own account or behalf, that is where one party is both guarantor and principal. Since this wording does not provide a context for any definitions, they would have to be presented, if deemed necessary, in other provisions.

6. Consideration may be given to adding the words "or persons" so as clearly to cover a possible plurality of beneficiaries as found, in particular, in the practice of financial stand-by letters of credit, which are customarily issued to multiple beneficiaries or to fiduciary representatives of multiple beneficiaries or sub-beneficiaries. This clarification may help to overcome problems in those jurisdictions where the rules of statutory interpretation would not lead to the conclusion that the singular includes the plural.

7. The wording between square brackets would embrace more than the expression "payment of money" found in article 2 URG. It would include units of account, as provided for in greater detail in article 5(1) of the United Nations Convention on International Bills of Exchange and International Promissory Notes (hereinafter referred to as "UNCITRAL Bills and Notes Convention"). Moreover, it would meet the concern expressed at the thirteenth session that a reference to the payment of money or currency might be too narrow in that it would exclude, for example, an undertaking to pay in gold (A/CN.9/330, para. 21).

* * *

Article 3. Independence of undertaking [1]

Variant A:[2] (1) An [international][3] undertaking is [deemed to be][4] independent, unless its terms[5] show that the payment obligation depends on the existence or validity of an underlying transaction between the principal and the beneficiary or of any other relationship except that created by the undertaking, or that the guarantor may invoke defences arising from a relationship other than its relationship with the beneficiary[6].

Variant B:[7] (1) An undertaking is independent if it does not depend on any underlying transaction or other relationship except that created by the undertaking.

[(2)[8] In determining whether or not a given undertaking is independent, any characterization or a single term found in the text of the undertaking shall not be deemed conclusive if the other terms and conditions clearly weigh in favour of the opposite result. In evaluating the terms and conditions in their totality, the following factors may be regarded as points weighing in favour of independence:

(a) Payment promised on "simple demand", "first demand", "demand", "receipt of written request" or words of similar import;

(b) Undertaking to pay qualified by expressions such as "unconditional", "irrespective of valid existence of X-Contract", "waiving all rights of objection and defences arising from said contract" or "without proof of default";

(c) Payment against documents, including statement by beneficiary, and not requiring verification of facts outside guarantor's purview;

(d) Reference to an underlying transaction only in a preamble or otherwise in a recital of what has gone before, and not in operative clauses;

(e) Undertaking stated to be subject to Uniform Customs and Practice for Documentary Credits or Uniform Rules for Guarantees.]

Remarks

1. This draft provision attempts to define the term "independent" used as a qualifying criterion in draft article 2. It may be noted that the term "independent" is defined here not merely as the opposite of "accessory", i.e. dependent on the underlying transaction between the principal and the beneficiary. The principle of independence as embodied in this draft provision is wider in that it establishes the autonomous character also in respect of other relationships such as that of the guarantor with a principal or instructing party.

2. Variant A is considerably more detailed than Variant B; its details will be explained below (remarks 3 to 6). Another difference that may be less obvious is that it incorporates a suggestion which the Working Group agreed to reconsider on the basis of a Secretariat draft. The suggestion was to regard an international undertaking as independent if it could not be interpreted as either independent or accessory (A/CN.9/330, paras. 95-96). While Variant B would not help in such case of doubt, Variant A solves the impasse of interpretation by excluding from the scope of application only those undertakings that are to be characterized as accessory or otherwise dependent, based on whatever rules of interpretation the Working Group may agree on.

3. The word "international" is not necessary in view of draft article 1. However, it might usefully be repeated here so as to emphasize that the suggested rule of favouring, in case of doubt, the independent legal character is limited to international undertakings.

4. The words "deemed to be" may, strictly speaking, not be correct as regards clearly independent undertakings. However, they may help to emphasize the above rule of doubt that, for the purposes of the uniform law, an undertaking will be treated as independent if it cannot be characterized as dependent.

5. Consideration may be given to adding after the words "its terms" the words "as interpreted in accordance with article 6 and paragraph (2) of this article". If the referred rules of interpretation were to be included in the uniform law, the suggested addition might help to clarify that a serious process of interpretation is required before such a level of doubt is established as to trigger the operation of the above rule.

6. Variant A defines in substance the term "dependent" by spelling out the possible links that negate the independent or autonomous character of the undertaking. It is submitted that the suggested demarcation line between "dependent" and "independent" is correct in principle. However, it will have to be reviewed and possibly refined in the light of the Working Group's conclusions on such issues as non-documentary conditions of effectiveness or payment, possible effect of illegality of the underlying transaction on the guarantor's obligation, and the extent to which facts pertaining to the underlying transaction may be asserted in the context of invoking fraud or manifest abuse.

7. Variant B is presented for two reasons. First, it is to show the opening words of a straightforward definition that does not incorporate the above rule of favouring independence in case of insoluble doubt. Secondly, it is to invite consideration of another definition of "independent" that is considerably shorter than that presented in Variant A.

8. Paragraph (2) is presented between square brackets with a view to soliciting the views of the Working Group on whether the uniform law should contain special guidelines for determining the independent character of an undertaking and whether it should go into such details, embracing current practice and actual language, as found in the sample indicators of independence. The paragraph also incorporates the suggested rule that a label or characterization may be disregarded in the light of conflicting terms found in the guaranty letter.

* * *

Article 4. Internationality [1]

Variant A:[2] A guaranty letter is international if:

(a) any two of the following places specified in the guaranty letter are situated in different States:

(i) [The place where the guaranty letter was issued][the place of business of the guarantor];
(ii) The place of business of the beneficiary;
(iii) The place of payment;
(iv) The place of business of [a principal or an instructing party][the person at whose request the guaranty letter was issued];
(v) The place of business of a confirming guarantor;

or

(b) if it expressly so states.

Variant B:[3] A guaranty letter is international if any two of the following [persons][parties] have their place of business in different States: guarantor, beneficiary, principal, instructing party, confirming guarantor.

Variant C:[4] A guaranty letter is international if:

(a) the guarantor and the beneficiary have their place of business in different States; or

(b) the place of issue and the place of business of a principal or an instructing party are situated in different States; or

(c) the place of issue and the place of payment are situated in different States;

or

(d) the guaranty letter relates in any other [significant] manner to more than one country.

Variant D:[5] A guaranty letter is international if it relates to an international operation, whether commercial or financial.

Remarks

1. This draft provision defines the term "international" used in draft article 1 and might later be added to that article. It presents four variants pursuant to the Working Group's request that the Secretariat prepare alternative draft versions of a test of internationality, taking into account the views and suggestions expressed at the thirteenth session (A/CN.9/330, paras. 51-57).

2. Variant A, like Variant B, lists a number of places out of which two must be in different States for a guaranty letter to be international. However, it requires those places to be specified in the guaranty letter so that banking and other personnel handling it may easily ascertain whether it is international. While the list of places in sub-paragraph (a) already covers the bulk of possible international links, sub-paragraph (b) would widen the scope of application by giving effect to a statement in the guaranty letter that it be regarded as international - in effect an opting-in clause in disguise. Such an option, which might also be included in Variant B, seems more appropriate in the context of Variant A with its requirement of specification. It could, for example, be used by the issuer of a financial stand-by letter of credit even though the place of business of the beneficiary or beneficiaries, likely to be foreign, is not specified or not even known.

3. Variant B differs from Variant A in two additional respects. It does not include the place of payment, which rarely differs from that of issue, and it lists the places of business of a principal and an instructing party as separate connecting factors, thus covering the case where a principal requests a bank in a different State to instruct another bank in that State to issue the guaranty letter. As regards the term "place of business", used also in Variants A and C, consideration may be given to supplementing the term by rules for those cases where a party has more than one place of business or does not have a place of business (along the lines of, e.g., article 10 United Nations Convention on Contracts for the International Sale of Goods, hereinafter referred to as "United Nations Sales Convention").

4. Variant C envisages only three defined links but embraces an uncertain number of other possible links by its sub-paragraph (d). This flexible formula introduces a degree of imprecision that may be undesirable at least if serious legal consequences would ensue.

5. Variant D is even more flexible and uncertain. While it may be appropriate in a given national law, where it is likely to have been developed by established case law, it seems less appropriate in a new uniform law of global origin and design.

* * *

Article 5. Interpretation of this Law

In the interpretation of this Law, regard is to be had to its international [character][origin][1] and to the need to promote uniformity in its application and the observance of good faith in international [transactions][guaranty or credit practice].[2]

Remarks

1. The term "character" has been used in various Conventions emanating from the Commission's work and would certainly be appropriate if the uniform law were to be adopted in the form of a convention. It might also be appropriate if the uniform law were to be promulgated in the form of a model law. In that case, it may, however, be technically more accurate to refer to its international origin.

2. The general term "transactions" has been used in the UNCITRAL Bills and Notes Convention and appears to be equally appropriate for the uniform law. However, if a more specific term were to be sought, the suggested alternative wording "guaranty or credit practice" might be the answer, particularly, if the final uniform law would cover traditional commercial letters of credit.

* * *

Article 6. Construction of guaranty letter [1]

Variant A:[2] (1) Subject to the provisions of this Law [and of any other applicable law][3], the rights and obligations of the parties are determined by the terms and conditions set forth in the guaranty letter, including any rules, conditions or usages referred to therein[4] [, and, unless otherwise stipulated, any international usage of which the parties knew or ought to have known and which is widely known to, and regularly observed by, parties to guaranty or credit transactions][5].

(2) The terms and conditions of the guaranty letter are to be interpreted according to the intent of the parties[6], taking into account the ordinary meaning in the understanding of a reasonable person with an appreciation of the commercial purpose of the transaction and with due consideration of any practices which the parties have established between themselves.[7]

Variant B:[8] In determining the rights and obligations of the guarantor and the beneficiary, the terms and conditions set forth, or referred to, in the guaranty letter are to be interpreted according to the ordinary meaning given to them by a reasonable person.

Remarks

1. The article heading might be modified if Variant A is maintained. It could, for example, read: "Determination of rights and obligations".

2. Paragraph (1) of Variant A is designed to introduce the principle of strict construction and to address the issue of party autonomy and its limits. The combination of both matters serves to draw attention to the fact that the rights and obligations flow from the terms of the undertaking but may be affected by mandatory provisions of law. As regards provisions of the uniform law itself, it will have to be decided for each provision whether or not parties may derogate therefrom.

3. The bracketed reference to "any other applicable law" might serve as a useful reminder of the fact that the rights and obligations of the parties may be affected by various mandatory provisions of law dealing with issues not governed by the uniform law (e.g. exchange control, supervision of banks,

capacity of parties or bankruptcy). However, such a reference has not normally been included in comparable legal texts and might be regarded as too general to be useful.

4. A reference in the guaranty letter to rules (e.g. uniform rules), conditions (e.g. general conditions) or usages does not affect the parties' rights and obligations if the reference is not valid under the applicable law. However, it does not seem necessary to express the requirement of validity in the draft provision.

5. The wording between square brackets is modelled on article 9(2) of the United Nations Sales Convention. Despite the difference in subject matter, there may be a need in the uniform law for giving effect to an international usage by way of implied agreement. However, the need might be less felt if the Working Group were to retain the incorporation of rules and usages in the guaranty letter (see above, remark 4) and the reference to any other applicable law (see above, remark 3) which could, for example, be customary law on letters of credit. If a more straightforward formula were to be desired, an international usage could be recognized even without an implied agreement and the element of knowledge.

6. The reference to the parties' intent as primary criterion of interpretation is inspired by article 8(1) of the United Nations Sales Convention. However, it is there used in respect of an individual party and given effect only where the other party knew or could not have been unaware what the intent was. The uniform law could use that individualized formula if, focusing on the undertaking, it would restrict the rule of interpretation to the rights and obligations of the guarantor. If applied to both parties, the criterion of intent retains its importance but seems in need of qualification by some flexible wording.

7. The suggested rule of interpretation attempts to strike a balance between the need for strictness in giving full faith and credit to the letter of the undertaking and the need for flexibility in introducing factors not necessarily apparent from the guaranty letter. While the balance is not easily struck, the suggested rule is thought to further two important policy objectives, namely to meet the expectations of the parties and to ensure the commercial utility of independent undertakings.

8. Variant B introduces the rule of interpretation with opening words that state the purpose of the interpretation and thereby reflect the idea of strict construction less directly than does paragraph (1) of Variant A. In respect of both Variants, it may be noted that the related issue of the standard of compliance of the claim with the terms of the guaranty letter will be addressed in a separate draft provision, in a future chapter devoted to the demand for payment.

* * *

II. ESTABLISHMENT, AMENDMENT AND EXPIRY

Article 7. Form and time of establishment [1]

(1) A guaranty letter may be established by any means of communication that provides a record thereof.[2]

Variant A[3]: (2) A guaranty letter becomes binding and, unless it expressly states that it is revocable, irrevocable, when it is received by the beneficiary [4][, unless the beneficiary promptly rejects it]. The guaranty letter becomes effective at that time [5], unless [it states a different time of effectiveness or makes its effectiveness depend on the occurrence of a specified, uncertain future event, in which case the guarantor may require a declaration from the beneficiary or an appropriate third party stating the occurrence of the event, if verification of that occurrence is not within the control of the guarantor][6] [it expressly provides that its effectiveness is subject to a specified condition that is determinable by the guarantor][7].

Variant B:[8] (2) Unless otherwise stated, a guaranty letter is effective and irrevocable, when it is issued by the guarantor to the beneficiary or to the principal or instructing party.[9]

Remarks

1. This draft provision on form and time applies to the establishment of a guaranty letter, that is, an undertaking meeting the essential requirements set forth in draft article 2. Whether the same rules on form and time should be applicable to later changes (e.g., amendment or cancellation) and to other communications (e.g. demand or notice) will be considered in a note by the Secretariat discussing further possible issues of the uniform law (A/CN.9/WG.II/WP.68).

2. Paragraph (1) is modelled on article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration. It is based on the view, widely supported at the thirteenth session (A/CN.9/330, para. 105), that the guaranty letter should be manifest or recorded in some tangible or material form, to the exclusion of purely oral undertakings.

3. Variant A of paragraph (2) is considerably more detailed than Variant B. While Variant B uses the expression "unless otherwise stated" for the entire paragraph, Variant A specifies what stipulations to the contrary would be admissible, in particular, as regards the time of effectiveness. Both Variants implement the Working Group's decision that the uniform law should provide for the irrevocability of all undertakings covered by it unless otherwise stated in the guaranty letter (A/CN.9/330, para. 102). That rule would override current article 7(c) UCP which, in case of silence, treats letters of credit as revocable.

4. Variant A uses as the determinant point of time the receipt of the guaranty letter by the beneficiary. That is based on the consideration that it

is only at that time that the beneficiary is in a position to rely on the guarantor's undertaking. The suggested rule does not take a stand on whether the undertaking is to be characterized as a contract, be it bilateral or unilateral, or as a special creation of commercial law. Whichever characterization would be appropriate, there appears to be general agreement in law and practice that no express acceptance by the beneficiary is required. However, consideration may be given to including a proviso on possible refusal of acceptance, as suggested at the end of the first sentence. If that proviso were maintained, consideration may be given to addressing such issues as qualified acceptance, legal effect of undertaking before rejection, or decisive point of time of rejection.

5. Variant A draws a distinction between "binding" and "effective". Without attempting here to define these terms, "binding" would indicate the existence of a promise made with the intention to be legally bound; such binding promise may, for example, establish the guarantor's right to charge a fee and it may be revoked, if revocable. "Effective" would indicate the operative character of the undertaking, entitling the beneficiary to demand payment in conformity with the payment conditions. For example, a repayment guarantee would be binding, but not effective, before the advance payment was made by the beneficiary or known to the guarantor.

6. The wording between square brackets presents two exceptions to the rule on the point of time of effectiveness. First, the guaranty letter may postpone the effectiveness to a later point of time, either a fixed date or a determinable time. Secondly, the guaranty letter may make its effectiveness subject to a condition; the suggested wording would not invalidate non-documentary conditions of effectiveness but would convert them into documentary ones. While conditions of effectiveness might be treated differently from payment conditions, as discussed during the thirteenth session (A/CN.9/330, para. 69), consideration may later be given to dealing with both types of conditions in one draft provision.

7. The alternative wording between square brackets is modelled on article 6 URG. It does not include the first exception, i.e. different time of effectiveness, and would invalidate or disregard any condition of effectiveness that was not determinable by the guarantor.

8. As indicated above (remark 3), Variant B would permit the parties to derogate from the entire draft provision. If it were adopted, the issue of non-documentary conditions of effectiveness would have to be dealt with in a separate provision, possibly in connection with non-documentary conditions of payment.

9. Variant B uses as the determinant point of time the issuance of the guaranty letter. That is based on the consideration that the guaranty letter, when issued or sent, leaves the sphere of control of the guarantor. In this respect, it might be regarded as irrelevant whether the guaranty letter is released towards the beneficiary or towards the principal or instructing party. While the rule would place the risk of transmission on the beneficiary, consideration may be given to distinguishing between the point of time of effectiveness and the risk of transmission.

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Fourteenth session
Vienna, 3-14 September 1990

INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT

Discussion of further issues of a uniform law: amendment, transfer, expiry, obligations of guarantor, liability and exemption

Note by the Secretariat

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INTRODUCTION

1. At its thirteenth session, the Working Group on International Contract Practices considered, on the basis of a note by the Secretariat (A/CN.9/WG.II/WP.65), possible issues of a uniform law on independent guarantees and stand-by letters of credit (A/CN.9/330). Those issues concerned the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Working Group also engaged in a preliminary exchange of views on issues relating to the form and time of establishment of a guaranty letter. It requested the Secretariat to submit to the next session a note discussing further possible issues to be covered by the uniform law (A/CN.9/330, para. 110).

2. The present note has been prepared pursuant to that request. It presents a discussion of issues relating to amendment, transfer and expiry of the guaranty letter, to obligations of the guarantor as well as liability and exemption. The Secretariat intends to submit at the fifteenth session of the Working Group a further note discussing the remaining issues: fraud and other objections to payment, injunctions and other court measures, conflict of laws and jurisdiction.

I. AMENDMENT

3. The Working Group may wish to consider whether the uniform law should contain provisions on the amendment of a guaranty letter. Such provisions could address questions such as the form and time of effectiveness of an amendment and whose consent is necessary for an amendment to be effective.

4. It may be noted that the ICC Draft Uniform Rules for Demand Guarantees (URG) 1/ do not contain any special provision on amendment, even though amendments are mentioned in some of its provisions (e.g. articles 1, 3, 16, 23 and 24). Presumably, the provisions on form and time of effectiveness of the original guarantee (articles 2(a) and 6)) are meant to apply by analogy to a later amendment.

5. The Uniform Customs and Practice for Documentary Credits (UCP) 2/ contain a number of provisions dealing with amendments to credits. For example, article 12 UCP sets forth the circumstances under which an instruction by any teletransmission to advise an amendment to a credit constitutes the operative amendment. According to article 10 d) UCP irrevocable "undertakings can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank (if any), and the beneficiary. Partial acceptance of amendments contained in one advice of amendment is not effective without the agreement of all the above named parties." The Working Group may wish to use this list of parties as a basis for its discussion on whose consent is needed for an amendment of the guaranty letter to be effective.

A. Parties whose consent is required

6. It is obvious that an amendment cannot be effective without the consent of the guarantor, whether it issued or confirmed the original guaranty letter. While the consent of the beneficiary may be viewed as an equally obvious requirement, doubts might arise with respect to amendments that increase the beneficiary's rights (e.g. extension of validity period). However, a particular increase in the beneficiary's rights may not necessarily be acceptable to the beneficiary since, for example, it may have requested an even longer extension of the validity period. Moreover, it would not be easy to administer a rule that would depend on whether the amendment in question was to the beneficiary's advantage.

1/ ICC Document No. 460/470-1/Int. 16, 470/622 and 460/382 (7 June 1990). This latest draft, which was not available to the Secretariat when preparing document A/CN.9/WG.II/WP.67, incorporates changes in the title, the introduction, articles 1, 2, 4 and 20. It seems particularly noteworthy that according to article 2 the rules now cover stand-by letters of credit. The introduction states: "Although for the time being UCP 400 also applies to stand-by letters of credit, it is envisaged that the present rules will be those adopted by parties to stand-by letters of credit".

2/ ICC Publication No. 400, reproduced in A/CN.9/251.

7. As in the context of the establishment of the original guaranty letter, consent need not necessarily mean express acceptance. Along the lines of Variant A of draft article 7(2) (A/CN.9/WG.II/WP.67), an amendment could become effective upon receipt by the beneficiary, unless the beneficiary rejected it promptly or within a specified period of time (e.g. 14 days). An alternative solution could be to treat silence and, possibly, partial or qualified acceptance as a rejection. For example, an amendment could be deemed to be rejected 21 days after its notification to the beneficiary unless the guarantor has received an unqualified acceptance from the beneficiary or has become aware of an act or conduct by the beneficiary in compliance with the terms of the amendment (e.g. submission of a required statement).

8. Another point in need of clarification is who exactly is covered by the term "beneficiary". As indicated in remark 6 to draft article 2 (A/CN.9/WG.II/WP.67), the original guaranty letter may have a number of beneficiaries, in particular in the practice of financial stand-by letters of credit. As regards amendments that come into play at a later stage yet other beneficiaries may have to be recognized, namely substitute beneficiaries and beneficiaries by operation of law. The substitute beneficiary is found in stand-by letters of credit as a replacement of the original beneficiary when the latter resigns or is removed by the represented beneficiaries, usually the holders of debt or equity securities. This substitution must meet the terms and conditions of the stand-by letter of credit, and compliance with those terms must be ascertained by documentary means. The transferee by operation of law is associated with transfers decreed by statutory, administrative or decisional law in instances where the original beneficiary is insolvent or incapable of acting as a beneficiary. The Working Group may wish to decide whether in any rule requiring the beneficiary's consent those special categories of substitutes or transferees should be expressly mentioned or whether general rules of interpretation would lead to the conclusion that they were covered as well.

9. The above list of parties in UCP whose consent is required does not include the principal or, as the UCP calls it, the applicant for the credit. In contrast, Section 5-106 (2) of the Uniform Commercial Code (UCC) provides: "Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be modified or revoked only with the consent of the customer and once it is established as regards the beneficiary it can be modified or revoked only with his consent." It may be noted that the Task Force on the Study of UCC Article 5 recommended that the provision should be changed so as not to require the principal's consent.

10. Support for requiring the principal's consent may stem from a concern about the principal's interest in protecting its relationship with the guarantor against interference by third persons as well as the principal's possible desire not to have its name connected with the amended guaranty letter.

11. The main reason for excluding the principal from the list of parties whose consent is required is the independence of the guarantor's undertaking, i.e., the guarantor's undertaking creates a legal relationship only between it and the beneficiary. The consent of the principal to the amendment is relevant to a separate legal relationship, namely that between guarantor and

the principal. Accordingly, the guarantor is free to modify its undertaking to the beneficiary without the principal's consent and is bound by the amended undertaking, but it does so at the risk of prejudicing its claim for reimbursement from the principal, depending on the instructions or the terms of the reimbursement agreement between the principal and the guarantor. Consideration might be given to drawing attention to the fact that the principal's consent may well be required under the legal relationship between the principal and the guarantor, by adding to the rule requiring the consent only of the guarantor and the beneficiary such wording as: "This provision does not excuse the failure to obtain the principal's consent, as it may be required by the agreement or instructions between the principal and the guarantor".

B. Form of amendment

12. As regards requirements of form for an amendment to be effective, one approach would be to require the same form as provided for in draft article 7(1) for the establishment of the original guaranty letter (A/CN.9/WG.II/WP.67), subject to any special stipulation in the guaranty letter concerning the form of amendments (see below, para. 15). This approach could be based on the view that an amendment constitutes a part of the guaranty letter and as such shares the legal nature and characteristics, including evidentiary value, of the guaranty letter.

13. However, one may also point out that an amendment constitutes but a small part of the terms and conditions of the guaranty letter and that current amendment practice tends to be less formal. It was reported at the thirteenth session that there existed a practice under which an amendment of a written guaranty letter might be made orally and authenticated in that form; while the amendment would then be confirmed by a message that provided a record of the agreement, the oral communication was in practice regarded as determining the point of time of effectiveness of the amendment (A/CN.9/330, para. 106).

14. If the Working Group wished to accommodate this and similar informal practices, it might consider not requiring any particular form but requiring authentication of the source of an amendment. The same requirement of authentication of source, which would include signature, would seem appropriate if the Working Group were to decide in respect of draft article 7(1) not to require any particular form for the establishment of the guaranty letter. If such a provision requiring merely authentication were to be adopted for the establishment or amendment of the guaranty letter and the uniform law was eventually incorporated into a convention, consideration might be given to adding a provision along the lines of article 12 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; hereinafter referred to as "United Nations Sales Convention").

15. While it is conceivable that prior to the establishment of the guaranty letter the guarantor and the beneficiary would have agreed on the required form of the guaranty letter, a stipulation on the required form for later amendments is more likely to exist. Thus, any general rule on form as discussed above would have to be made subject to contrary stipulation. For the sake of clarification, one might include a provision to the effect that the guaranty letter may not be amended other than in the stipulated form (along the lines of article 29(2) United Nations Sales Convention). Consideration might be given to adopting also the last sentence of that

paragraph, which reads: "However, a party may be precluded by his conduct from asserting such a provision to the extent that the other party has relied on that conduct". The underlying principle appears to be equally appropriate in the context of guarantee and credit practice, even though in the context of a sales transaction there may be more instances of conduct on which reliance is placed that deserves to be protected.

C. Time of effectiveness

16. The point of time when an amendment becomes effective could be the same as that provided in draft article 7(2) for the establishment of the guaranty letter. However, in view of the required consent of the beneficiary, that result would be less appropriate if Variant B of draft article 7(2), using the time of issue as the time of effectiveness, were to be chosen (A/CN.9/WG.II/WP.67). Even Variant A, using the time of receipt by the beneficiary, might need some qualification.

17. For example, if an amendment would be deemed to be rejected unless accepted in full within a specified period of time, the determining point of time of effectiveness could be the time when the guarantor receives notice of the acceptance. If the opposite solution were to be adopted, namely that there was a presumption in favour of acceptance, the receipt of the amendment by the beneficiary might be appropriate as the determining time, even though its effectiveness might be subject to a rejection or qualified acceptance within the specified period of time. The use of the beneficiary's receipt of the amendment as the determining point of time could also accommodate the practice reported at paragraph 13 above that an oral amendment with authentication as to source would be effective even though a formal confirmation may be required or, at least, suggested by sound banking practice.

II. TRANSFER OF RIGHTS AND ASSIGNMENT OF PROCEEDS

18. The Working Group may wish to consider whether the uniform law should address the issue of the beneficiary's transfer of rights and assignment of proceeds. The use of the terms "transfer" and "assignment" is drawn from the UCP, which establish in article 54 a special legal regime for the transferable letter of credit and permit in article 55 the assignment of the proceeds of a credit. The term "assignment", which is used in the broader legal context to refer to a transfer of rights and obligations under a contract, is used in the UCP in the restricted sense of assignment of the proceeds. A change of the holder of the right to claim payment is referred to as "transfer". The UCP provisions on transferability require that the credit be expressly designated as "transferable" by the issuing bank, they require the consent of the bank requested to effect the transfer, whether or not it has confirmed the credit, and they permit only a single transfer of the credit.

19. The URG depart from the terminology and substance of the UCP provisions. Article 4 URG reads as follows: "The Beneficiary's right to claim under a Guarantee is not assignable unless expressly stated in the Guarantee wording

itself or in an amendment thereto. This article shall not, however, affect the Beneficiary's right to assign any proceeds to which he may be, or may become, entitled under the Guarantee". Only the term "assignment" is used and, while the UCP distinction between the claim and the proceeds is maintained, no mention is made of a limit on the number of possible transfers.

20. If the Working Group were to decide that the uniform law should contain provisions on transfer of rights and on assignment of proceeds, it might wish to consider the following points concerning the mechanics and consequences of a transfer and of an assignment. As regards assignment of proceeds, it might be useful to clarify that the object of an assignment is merely the proceeds, i.e. any funds that will be forthcoming when the guarantor honours its payment obligation. Accordingly, the assignee is not entitled to claim payment or to present any statement or document that may be required in order to claim payment, since that may change the risk to which the principal and the guarantor have agreed to be exposed. The position of an assignee is thus weaker than that of a transferee in that a beneficiary, having obtained funds from the assignee in exchange for the assignment, would be able to block payment to the assignee by not submitting a claim for payment. Another clarification could be to require a notice of assignment from the beneficiary to the guarantor, or possibly even a notice of acknowledgement by the guarantor, so as to create certainty as to whom the guarantor is supposed to pay and thereby discharge its payment obligation under the guaranty letter. Yet another issue that might be addressed is whether only one assignment of the proceeds should be allowed and whether such an assignment should have to be of 100 per cent of the proceeds.

21. As regards the possible transfer of the beneficiary's right to claim payment, two special features of independent guarantees and stand-by letters of credit need to be taken into account when formulating appropriate rules in view of the different interests involved. Firstly, where a guaranty letter is given in support of an underlying obligation of the principal, the true beneficiary should be the one to whom performance of that underlying obligation is owed and who is in a position to declare, or submit documents establishing, default. While the guarantor does not usually judge the reliability of the beneficiary before issuing its guaranty letter, it is expected to bear in mind the interest of the principal, who usually has judged the reliability of the beneficiary before establishing its relationship with the beneficiary. In this vein, a transfer of the beneficiary's right to demand payment makes sense where the creditor to the underlying obligation has changed.

22. A second special feature becomes apparent in comparison with a traditional commercial letter of credit. There "only the original beneficiary, if it is a non-transferable credit, or the second beneficiary if the credit is transferable, is entitled to tender the documents that will prompt the issuing bank's payment. Yet, where a bank issues a financial standby promising to pay the beneficiary and the holder of the unpaid promissory note, draft or demand for payment, the bank also extends the promise to receive the tender of documents to whomever the original beneficiary transfers the note, draft or demand for payment and accompanying documents, if any. This differs from the promise in the circular-negotiation type of commercial letter of credit (whose language of negotiation, incidentally, is nonetheless usually incorporated in

the text of the financial standby) because the negotiation contemplated in the circular commercial letter of credit is of the draft only. It does not presuppose the transfer of the right to tender the documents that comply with the text of the credit, a right which, most often, is exercised by the beneficiary prior to negotiating the draft." 3/

23. These two special features may be taken as suggesting the following conclusions. The beneficiary should not be free to transfer its right to payment whenever it so wishes; it may do so only if permitted under the guaranty letter and thus presumably with the principal's consent. The above description of a financial stand-by letter of credit suggests, however, that a requirement such as express statement or express designation as "transferable" would be too narrow. One might even view the transfers envisaged in such an undertaking as expected changes of the individuals covered by the original undertaking and not as transfers in the technical sense of the term. Yet another conclusion might be that more than a single transfer should be permitted if so stipulated in the guaranty letter. Finally, consideration may be given to clarifying, in the absence of a clear answer in the guaranty letter, whether only the transferee is entitled to claim payment and present any required statement or document or whether the transferor, i.e., the original beneficiary, is supposed to do so on the transferee's account.

III. EXPIRY

24. Certainty about the expiry of the guaranty letter is at least as important as certainty about the time when the guaranty letter becomes effective (see draft article 7(2), A/CN.9/WG.II/WP.67). The uniform law might help to enhance certainty in two respects. It could clarify the meaning and effect of expiry as stipulated in the guaranty letter, and it could address various issues relating to party autonomy in stipulating expiry terms.

A. Meaning and effect

25. A stipulation that the guarantee or stand-by letter of credit expires on a given date is widely understood to mean that a demand for payment, accompanied by any required documents, may be made only before or on that date and that, accordingly, the guarantor is not obliged to pay upon any demand made after that date. However, courts of some jurisdictions have given a different interpretation, namely that merely the contingency for which the guarantee had been given must have occurred before or on the expiry date, and have recognized a demand for payment made after that date, either within a reasonable time thereafter or even during a period of limitation or prescription, which may extend long after the expiry date.

3/ Kozolchyk, The Emerging Law of Standby Letters of Credit and Bank Guarantees, 24 Arizona L.R. (1982), 319, 356.

26. The uniform law might usefully clarify matters by prescribing the first interpretation, as is done in a number of national laws. For example, the 1963 International Trade Code of Czechoslovakia provides in Sect. 671:

> "If the validity of the banking guaranty is limited in time, the entitled person shall notify the bank of his claims not later than within such time; otherwise his claims under the banking guaranty shall be extinguished." 4/

27. Very similar provisions are found in the laws of Bahrain, 5/ Iraq 6/ and Kuwait. For example, the 1980 Commercial Law of Kuwait provides in Art. 386:

> "The bank shall be discharged of liability vis-a-vis the beneficiary if within the validity period of the letter of guarantee no request for payment is received from the beneficiary, unless it had been expressly agreed to renew said term prior to its expiry." 7/

28. As regards uniform rules, the same interpretation of expiry appears in the last sentence of article 22 URG ("Claims received after the Expiry Date or Expiry Event shall be refused by the Guarantor") and in article 19 URG:

> "A claim shall be made in accordance with the terms of the Guarantee on or before its expiry and, in particular, all documents specified in the Guarantee for the purpose of claiming shall be presented to the Guarantor on or before its expiry at its place of issue, otherwise the claim shall be refused."

29. If the Working Group were to adopt a provision in support of the first interpretation, i.e., that the claim for payment must be made within the validity period, an exception might have to be made where the expiry clause in the guaranty letter provides otherwise (e.g., undertaking to pay in the event of the principal's default within a definite period of time). A possible solution for that exception might be to grant additional time, either a fixed or a reasonable period, for submitting the demand and the required documents. The same should probably apply where a counter-guarantor promises to indemnify the guarantor for any payment made before the expiry of its guaranty letter, provided the counter-guaranty letter contains no other expiry clause, such as a specific expiry date. Here, as in any other case, each guaranty letter stands on its own as regards its time of effectiveness and expiry.

4/ Act No. 101 (of 4th December, 1963) on Legal Relations arising in International Business Transactions, see Introduction and Commentary by Kopac (Prague 1967), p. 201.

5/ Art. 335(1) of the Commercial Code of Bahrain, Law No. 7 of 1987.

6/ Art. 291(1) of the Commercial Code of Iraq, Law No. 30 of 1984.

7/ Decree No. 68 of 1980 Enacting the Law of Commerce of Kuwait.

30. The effect of expiry that payment may no longer be demanded has been described in the above sample provisions (paras. 26-28) by such expressions as "claims shall be extinguished", "bank shall be discharged of liability vis-a-vis the beneficiary", and "claim shall be refused". A provision to that effect in the uniform law could enhance certainty by making it clear that the effect of expiry does not depend on any further act such as return of the guaranty letter or a declaration of release by the beneficiary. It is submitted that such an automatic effect should obtain even where a clause in the guaranty letter requires the return of the instrument or a declaration of release. As regards the issue of the return of the instrument, article 24 URG provides:

> "Where a Guarantee has terminated by payment, expiry, cancellation or otherwise, retention of the Guarantee or of any amendments thereto shall not preserve any rights of the Beneficiary under the Guarantee."

31. Such a rule is useful in that it prevents uncertainty and the risk of everlasting enforceability. It takes into account that there are various possible reasons for retaining the guaranty letter and that the very idea of return or retention is becoming less applicable in the context of modern means of communication. Above all, it helps to dispel the misconception that the guaranty letter would be an instrument that, as a negotiable instrument does, carried in it the right to payment so as to require possession and presentment of the instrument for the enforcement of that right. The advantage of having in the uniform law a provision along the lines of article 24 URG would be that the uniform law, unlike uniform rules that become effective by agreement, would make inapplicable any contrary provision of law in the State enacting the uniform law.

32. It is doubtful whether the same need exists for incorporating in the uniform law a provision along the lines of article 23 URG, which also touches on the issue of return or retention in dealing with pre-expiry events that free the guarantor from liability and thus make expiry obsolete:

> "Irrespective of any expiry provision contained therein, a Guarantee shall be cancelled prior to the Expiry Date or Expiry Event on presentation to the Guarantor of the Guarantee itself or the Beneficiary's authenticated statement of release from liability under the Guarantee, whether or not the Guarantee or any amendments thereto are returned."

33. If a provision along those lines were to be included in the uniform law, the Working Group may wish to consider the following two points. Firstly, the expression "shall be cancelled" might be reworded so as to make clear that the effect is automatic and does not depend on any further act or declaration. Secondly, it might be too rigid to attach the effect of cancellation to the "presentation to the Guarantor of the Guarantee itself" in that it could be construed as extending beyond those cases where the presentation constitutes an implied release or waiver and, for example, covering the case of an erroneous return.

B. Party autonomy and possible limits

34. The preceding discussion of the meaning and effect of expiry assumed the existence of a valid expiry clause. An expiry clause may be found in the guaranty letter or, in particular where the validity period has been extended, in an amendment to the guaranty letter (as discussed above, paras. 3-17; it may be noted that the Secretariat intends to discuss the problems surrounding so-called "extend or pay" demands in a future note). To be discussed now are two issues relating to party autonomy in stipulating expiry clauses. The first issue concerns the modalities of determining the time of expiry, in particular the reference to an expiry event rather than an expiry date. The second issue is whether a guaranty letter must contain an expiry clause and, if so, what the sanction for failure should be. In this context it will be asked whether the uniform law should provide for a cut-off period and, if so, what its legal character should be.

1) Modalities of determining the time of expiry

35. The time of expiry may be fixed in a number of ways. The most certain way is to fix a calendar date. Another way is to state a definite period of time (e.g. six months). Since some uncertainty might exist as to the exact starting point of that period of time, the uniform law might help by referring to the time of effectiveness (according to draft article 7(2); A/CN.9/WG.II/WP.67). Yet another way is to specify a certain act or event (e.g. completion of principal's performance, acceptance of works by beneficiary, award of contract to another tenderer). Expiry clauses of that kind may create problems in two respects.

36. Firstly, where expiry is linked to an event, the guarantor would have to engage in an undesirable examination of facts and might become entangled in a dispute between the beneficiary and the guarantor. Since the deliberations of the Working Group on the so-called non-documentary payment conditions (A/CN.9/330, paras. 68-75) seem applicable here, consideration may be given to converting any non-documentary expiry that is not readily determinable by the guarantor into a documentary one. The documentary approach is taken by article 22 URG (first sentence) which appears to qualify the presentation of documents itself as expiry event:

> "Expiry of a Guarantee for the presentation of claims shall be upon a specified calendar date ('Expiry Date') or upon presentation to the Guarantor of the document(s) specified for the purpose of expiry ('Expiry Event')."

37. Secondly, expiry that is linked to an event may never occur or at least not for a long time. Even where presentation of a document is required, there may be a risk of an everlasting undertaking, at least if the document is to be furnished by the beneficiary. The most effective cure would be not to recognize expiry clauses based on an event and thus to allow only the specification of a calendar date or a definite period of time. However, that cure might be regarded as too rigid. Another cure might be provided by the cut-off period discussed below (paras. 42-43) or, for certain extreme cases, by provisions dealing with fraud or manifest abuse (to be discussed in a future Secretariat note).

2) Possible requirement of an expiry clause and possible cut-off period

38. The Working Group may wish to consider whether the uniform law should require guaranty letters to contain an expiry clause and, if so, what the consequence of a lack of such a clause should be. It may be noted that the URG appear not to require an expiry clause and do not provide for any sanction in case of failure to contain such a clause. While article 22 URG (quoted above, para. 36, in its essential part) might be read as requiring an expiry date or expiry event, article 3 f) URG takes a hortatory approach by stating that "all guarantees should stipulate the expiry date and/or expiry event of the Guarantee".

39. Expiry clauses might be missing in guaranty letters due to omission or oversight. Even where they are intentionally left out, the result is at least uncertainty and possibly an undertaking of indeterminate effectiveness or perpetual enforceability. As was noted at the thirteenth session (A/CN.9/330, paras. 24 and 44), perpetual undertakings may be regarded as unsettling and commercially undesirable. They may raise regulatory concerns in view of the continuing risk exposure, and they may lead to increased costs under the capital adequacy rules of the Basel Agreement. Finally, they create uncertainty in that they might be affected by a period of limitation or prescription of an applicable law which in itself might be difficult to determine. It may be added that this uncertainty is aggravated by the following disparities between national laws of limitation or prescription: limitation periods vary considerably and may be as long as 30 years; limitation periods may commence to run at the establishment of the guaranty letter, the occurrence of the secured contingency or the time of the demand; limitation periods may or may not be shortened by the parties; foreign guaranty letters may or may not be subjected to domestic limitation periods.

40. The following reasons may be advanced against requiring an expiry clause. Since undertakings that do not specify a period of effectiveness are found in practice, the uniform law should not attempt to change that practice. Concerns relating to undertakings of indeterminate validity are not primarily due to the lack of an expiry clause since the same objections could be raised against clauses providing for perpetual or very long validity.

41. If the Working Group were to decide in favour of requiring an expiry clause, it would have to decide what the consequence of a lack of expiry clause should be. One possible sanction would be to treat the guaranty letter as invalid or ineffective. However, that sanction would probably be too extreme.

42. A more acceptable solution, as suggested during the thirteenth session of the Working Group (A/CN.9/330, paras. 25 and 46), would be to provide for a cut-off period of, say, five years. The cut-off period would apply only if the guaranty letter or an amendment thereto were not to contain an expiry clause. Due to its supplementary character, it would not prevent the stipulation of a longer period of effectiveness.

43. However, that solution would not meet the above concerns relating to undertakings of perpetual or excessively long validity. Consideration might thus be given to providing that the cut-off period may not be derogated from. If the cut-off period were to be mandatory, it should probably be longer than if it were to be supplementary (e.g. ten years). Whether mandatory or not, the cut-off period should be given the meaning and effect discussed above (paras. 25-33).

IV. OBLIGATIONS OF GUARANTOR

44. The following discussion deals with the most crucial situation in a guaranty letter transaction, i.e., when the beneficiary demands payment. It focuses on various issues relating to the obligations of the guarantor and is meant to include the counter-guarantor and the confirming guarantor. In considering those issues, a recurrent question will be whether they should be addressed in provisions of the uniform law and, if so, whether the provisions should be of mandatory or supplementary character. The question seems particularly pertinent in respect of issues on which rules are provided in the URG.

A. Obligation to pay upon conforming demand

45. As suggested in draft article 2 (A/CN.9/WG.II/WP.67), the guarantor is obliged to pay "in conformity with the terms of the undertaking". Upon receipt of a demand for payment, the guarantor would thus examine its conformity with the terms of the guaranty letter. It may be noted that a future Secretariat note will discuss possible grounds for refusing payment that are not instances of non-conformity (e.g. fraud, manifest abuse).

46. The points that the recipient of a claim would have to verify in order to decide whether it is obliged to pay under the guaranty letter may be illustrated by the following list:

Timeliness, i.e., the claim is not made after expiry

Proper claimant, i.e., the person demanding payment is the beneficiary designated in the guaranty letter

Proper form, i.e., the claim meets any requirement of form laid down in the guaranty letter or in the applicable law

Proper addressee and place of presentment, i.e., payment is demanded from the obliged party (e.g. guarantor, but not the advising bank) and the claim is presented at the right place in respect of that party (e.g. issuing bank or confirming bank)

Appropriate amount, i.e., the amount claimed does not exceed the maximum amount as stated in the guaranty letter or as reduced either by a previous payment or according to an express reduction clause

Fulfilment of payment conditions, i.e. presentment of specified documents or fulfilment of other requirements upon which payment is predicated

47. As regards the proper form of the demand, the Working Group may wish to consider whether the uniform law itself should contain any requirement as to form and, for example, whether it should exclude purely oral demands.

48. The Working Group may wish to consider whether the uniform law should contain a provision on the proper place. The rule in article 19 URG that a claim under the guarantee shall be made "at the place of its issue" might be refined so as clearly to link presentment to the particular addressee, e.g. confirming instead of issuing bank, and to give effect to any stipulation of a different place of presentment.

1) Standard of examination as to conformity

49. Article 9 URG provides:

> "All document(s) specified and presented under a Guarantee, including the claim, shall be examined by the Guarantor with reasonable care to ascertain whether or not they appear on their face to conform with the terms of the Guarantee. Where such document(s) do not appear so to conform or appear on their face to be inconsistent with one another, they shall be refused."

50. It is primarily in the context of verifying payment conditions that the standard of examination for facial conformity comes into play. Even where payment depends on the occurrence of an event and that occurrence is not within the guarantor's purview, an examination of documents would be required if the uniform law would incorporate the prevailing view at the thirteenth session (A/CN.9/330, para. 75) that non-documentary payment conditions should be converted into documentary ones obliging the beneficiary to submit a statement affirming the occurrence of the event in question or a certificate of an appropriate third person.

51. The standard of facial compliance may also play a role in the examination of other points included in the above illustrative list (para. 46). For example, where expiry is linked to an event, verification of timeliness may involve examination of documents, in particular if the uniform law were to adopt the documentary approach suggested above (para. 36). Similarly, where a reduction clause refers to an event, determination of the appropriate amount may involve examination of documents, in particular if the uniform law were to require that, as suggested at the thirteenth session (A/CN.9/330, para. 22), the available amount be readily determinable by the guarantor, for example, on the basis of clearly specified documents.

52. The Working Group may wish to consider whether a rule such as the one in article 9 URG would be appropriate for the uniform law and whether it should be refined or supplemented. In doing so, the Working Group may build on its discussion of the thirteenth session relating to the doctrine of strict compliance and to the possible use of the understanding and established practices of bankers as a criterion of the standard of construction and care (A/CN.9/330, paras. 86-91).

53. As was noted at the thirteenth session, the term "strict compliance", as distinguished from "substantial compliance", could be understood as meaning true strictness down to the comma or it could be understood as allowing a marginal latitude to correct typographical errors or similar minimal deviations. In fact, there exists no uniform understanding, and the handling of discrepant documents in letter of credit practice appears to be a primary source of disputes and litigation.

54. In considering whether a rigid or a more flexible standard of compliance would be appropriate, account should be taken of certain differences between the commercial letter of credit and the guaranty letter. Firstly, the commercial letter of credit provides a secured payment mechanism likely to be utilized in the ordinary course of the transaction, while the guaranty letter is designed to indemnify the beneficiary for the consequences of a contingency that is unlikely to occur. Secondly, the documents tendered under a

commercial letter of credit (e.g. bill of lading) are likely to be merchantable, while the statements or documents required under a guaranty letter are rarely of such type. Thirdly, the documents required under a commercial letter of credit tend to be more standardized than those required under a guaranty letter, and they are explained and regulated in detail by the UCP.

55. The following three examples might help to assess the possible role of the standard of facial compliance in guaranty letter practice:

A) A financial stand-by letter of credit contains in its annex the text of three statements describing the possible contingencies for which the undertaking is given and leaving blanks for the amount to be filled in by the beneficiary.

(In such case, the well-known maxim of the doctrine of strict compliance is clearly applicable: There is no room for documents that are almost the same, or that will do just as well)

B) A tender guarantee is payable on first demand accompanied by a written statement of the beneficiary certifying that the tenderer did not honour its commitment. The beneficiary sends the following facsimile message to the guarantor: "We hereby demand payment of 125.000 USD, confirming Company X did not sign awarded contract. Signed B." The guarantor refuses to pay because the beneficiary's statement contained neither the word "certify" nor the words "did not honour its commitment".

(However one may judge the reasons given for rejecting the claim, it is submitted that this case illustrates the limitations of the doctrine of strict compliance, whether or not interpreted in its literal, rigid sense)

C) A performance guarantee states that it is payable on simple demand and that it is subject to the URG. The beneficiary supports its demand by a declaration to the effect that the principal defaulted on its obligations, in particular, its main obligations under the contract. The principal instructs the guarantor not to pay because the beneficiary did not state, as required under article 20 a) ii) URG, "the respect in which the Principal was in breach". 8/

8/ Article 20 a) URG reads: "Any claim for payment under the Guarantee shall be supported by a written statement (whether in the claim itself or in a separate document or documents accompanying the claim and referred to in it) stating:

(i) that the Principal is in breach of his obligation(s) under the underlying contract(s);

and

(ii) the respect in which the Principal is in breach."

(Article 20 c) URG reads: "This Article applies except to the extent that it is expressly excluded by the terms of the Guarantee or Counter-Guarantee.")

(This latter wording, which may equally be found in an individually drafted text of a guaranty letter, exemplifies the frequent vagueness of the description of the required contents of a statement by the beneficiary and, in turn, of the limited utility of a standard based on strict compliance. In determining the conformity of a statement with the requirements contained in the guaranty letter, construed in accordance with draft article 6 of the uniform law, a process of interpretation and judgment is needed that cannot be appropriately covered by a single term such as "strict compliance", and probably also not "substantial compliance")

56. One conclusion would be that it is primarily for the parties to provide greater certainty by formulating precise requirements, illustrated in the first example. As regards the uniform law, a standard of facial compliance, however strict or flexible it may be, might have less significance than the standard of reasonable care in examining the conformity of the claim, including any required documents, with the terms of the guaranty letter.

57. In this connection consideration may be given to refining the standard of care, for example, by referring to the understanding of a reasonable and experienced documents checker. Such refinement might help to prevent an overly rigid attitude towards conformity where a process of interpretation and judgement is needed. However, one might regard such refinement as unnecessary in view of the fact that any legal standard of care tends to be judged with regard to the relevant group of persons and that the uniform law may be expected to include the mandatory requirement that guarantors act in good faith and with reasonable care (as provided in the new version of article 15 URG; see below, paras. 67-68).

2) Time allowed for examination

58. Article 10 a) URG provides:

"A Guarantor shall have reasonable time in which to examine a claim under a Guarantee and to decide whether to pay or to refuse the claim."

59. Except for minor drafting changes, this provision corresponds with the previous version which the Working Group reviewed at its twelfth session (A/CN.9/316, paras. 50-51). As was then noted in favour of retaining the notion of "reasonable time", the notion is well known, in particular from article 16 c) UCP, and takes into account differences in circumstances found in individual cases as well as regional and national variations in practice.

60. However, such flexibility is necessarily coupled with uncertainty that might not be desirable in international practice. With a view to achieving certainty, various proposals were made concerning inclusion of a definite period, e.g. five days or, as provided by Sect. 5-112(1)(a) UCC, three days. One compromise suggestion was to use a rebuttable presumption of a certain fixed length of time as appropriate, unless agreed or proven otherwise, with the burden being on the party alleging its reasonableness.

B. Duties of notification

61. The Working Group may wish to consider whether the uniform law should oblige the guarantor, upon receipt of a claim, to inform the principal or instructing party thereof. 9/ It may also wish to consider the time and modalities of the notice to the beneficiary that the guarantor would be obliged to give if it rejected the claim. Both duties are laid down in provisions of the URG (which in an earlier, somewhat different version were reviewed by the Working Group at its twelfth session, A/CN.9/316, paras. 50, 52, 72-75):

Article 10 b)

"If the Guarantor decides to refuse a claim, it shall immediately give notice thereof to the Beneficiary by teletransmission or, if that is not possible, by other expeditious means. Any documents shall be held at the disposal of the Beneficiary."

Article 17

"Without prejudice to the terms of Article 10, in the event of a claim the Guarantor shall without delay so inform the Principal or where applicable its Instructing Party and in that case the Instructing Party shall so inform the Principal."

62. With respect to the provision on notice of rejection, the Working Group suggested at its twelfth session that the notice should include a statement of the reasons for the rejection since a beneficiary, if informed of the nature of a documentary discrepancy, might be in a position to cure the discrepancy and re-submit the document in question. A consequential proposal was that the provision might include a rule of preclusion, perhaps similar to the one contained in article 16 UCP, thereby limiting the right of a guarantor to reject a submission of documents on the basis of discrepancies that could or should have been notified to a beneficiary during an earlier submission (A/CN.9/316, para. 52). It may be added that a rule of preclusion that was closely modelled on article 16 e) UCP would have the further consequence of precluding a guarantor who failed to examine the documents within the required period of time from claiming that they were not in accordance with the terms and conditions of the guaranty letter. The rule of preclusion would thus provide the sanction for failure to comply with the rule on the time for examination discussed above (paras. 58-60).

63. As regards the guarantor's duty to inform the principal or instructing party in the event of a claim, it is likely to be controversial in principle and to create difficulties in its implementation, in particular with respect to the guarantor's duty to pay upon a conforming demand. For example, questions were raised at the twelfth session as to whether notice should be given prior to payment, or whether payment could validly be made without notice and whether the notification, if made prior to payment, should contain

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9/ As to the term "instructing party", see draft article 2, A/CN.9/WG.II/WP.67.

information concerning the guarantor's intention to honour or dishonour the claim. In considering these and other questions relating to this duty, the Working Group may wish to take into account the opening words that were added to the new version of article 17 URG: "Without prejudice to the terms of Article 10", i.e. the provisions on the time for examination and on the duty to give notice of rejection.

64. Finally, the Working Group may wish to consider whether the uniform law should deal with further duties of notification. For example, consideration might be given to requiring financial institutions that receive a request for issuing a counter-guaranty letter or for confirming or advising a guaranty letter and that elect for any reason not to comply with such request to so inform the requesting party within a specified time, e.g. five days, after the receipt of the request.

V. LIABILITY AND EXEMPTION

65. The Working Group may wish to consider whether the uniform law should contain provisions on the liability of guarantors and, possibly, instructing parties. It may use as a basis of its discussion the pertinent URG provisions, an earlier version of which it reviewed at its twelfth session (A/CN.9/316, paras. 53-69). The relevant provisions of URG are:

Article 11

"Guarantors and Instructing Parties assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification, or legal effect of any document presented to them or for the general and/or particular statements made therein, or for the good faith or acts and/or omissions of any person whomsoever."

Article 12

"Guarantors and Instructing Parties assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any messages, letters, claims or documents, or for delay, mutilation or other errors arising in the transmission of any telecommunication. Guarantors and Instructing Parties assume no liability for errors in translation or interpretation of technical terms and reserve the right to transmit Guarantee texts or any parts thereof without translating them."

Article 13

"Guarantors and Instructing Parties assume no liability or responsibility for consequences arising out of the interruption of their business by acts of God, riots, civil commotions, insurrections, wars or any other causes beyond their control or by strikes, lock-outs or industrial action of whatever nature."

Article 14

a) "Guarantors and Instructing Parties utilising the services of another party for the purpose of giving effect to the instructions of a Principal do so for the account and at the risk of that Principal."

b) "Guarantors and Instructing Parties assume no liability or responsibility should the instructions they transmit not be carried out even if they have themselves taken the initiative in the choice of such other party."

c) "The Principal shall be liable to indemnify the Guarantor or the Instructing Party, as the case may be, against all obligations and responsibilities imposed by foreign laws and usages."

Article 15

"Guarantors and Instructing Parties shall not be excluded from liability or responsibility under the terms of Articles 11, 12, and 14 above for their failure to act in good faith and with reasonable care."

66. The discussion may conveniently be divided into two parts, dealing first with issues addressed in article 15 URG, the only provision imposing liability, and then with issues raised by articles 11 to 14 URG, which, while presented in the URG under the heading "Liabilities and responsibilities", contain in substance exemption clauses.

A. Liability and standard of care

67. It may be recalled that the previous version of article 15 URG imposed liability on guarantors and instructing parties "for their grossly negligent or willful acts". The new basis of liability, "failure to act in good faith and with reasonable care", reflects the view widely supported in the Working Group that guarantors and instructing parties should exercise reasonable care in performing their obligations (A/CN.9/316, para. 69).

68. A provision in the uniform law along the lines of article 15 URG would have a different legal character and possibly a different scope. Article 15 URG limits the effect of exemption clauses contained in the same set of rules, all of which, including article 15, become effective by agreement of the parties and may thus be excluded or varied. The uniform law, however, would be in a position to impose liability in a mandatory fashion. Thus it could effectively limit any exemptions from such liability, whether they be found in individually drafted clauses of guaranty letters or in general conditions or uniform rules referred to in guaranty letters.

B. Exemptions from liability

69. As regards articles 11 to 14 URG, the current provisions are essentially the same as those reviewed by the Working Group at its twelfth session. It may be recalled that serious objections were raised, in particular, in respect of articles 12 to 14 URG which were regarded as unduly favouring guarantors and instructing parties. Suggestions were made that those exempting provisions should be deleted or drafted in a more balanced manner.

70. It was pointed out in response that the provisions were closely modelled on articles 17 to 20 UCP which had not given rise to difficulties. As regards the exemption for force majeure it was stated that guarantee texts often contained force majeure clauses and that even without any contractual exemption a similar result would obtain from the applicable national law. However, since national laws differed as to the scope of exempting impediments, it might be desirable to strive for a greater degree of harmony.

71. In discussing whether the uniform law should include any of the exemptions contained in articles 11 to 14 URG, the Working Group may wish to take into account the following considerations based on differences between the URG and the uniform law. While the future acceptability of the text to bankers as the primarily concerned persons will be an important factor in a State's decision about the acceptance of the uniform law, that may be less so in respect of exemption clauses since these are more commonly promulgated by the interested circles, for example, in general conditions.

72. Moreover, the need for including in the uniform law provisions on exemption appears to be reduced by the very fact that the the URG contains exemption clauses. Finally, exemption clauses seem to be more appropriate in a text that itself spells out the various obligations, the breach of which raises the question of liability and exemption therefrom. There may thus be less need for including exemption clauses in the uniform law, which, whatever its final coverage will be, is certain to contain fewer "rules of traffic" and provisions imposing duties than the URG.